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In the

Supreme Court of the United States

OCTOBER TERM, 1966

No. 798

WEST LOS ANGELES INSTITUTE FOR CANCER RESEARCH, a corporation,
Petitioner,

v.

WARD MAYER, MARJORIE MAYER, R. W. MAYER, and TIMBER STRUCTURES, INC., a corporation, individually and as successors in interest to Ward Mayer Structures, Inc.,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Petitioner, West Los Angeles Institute for Cancer Research, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit entered in the above-entitled case on August 29, 1966.

OPINIONS BELOW

The opinion of the District Court (Tr. 1110-1145, 1197-1201) is unreported. The opinion of the United States Court of Appeals for the Ninth Circuit is not yet reported. It is printed in the Appendix, infra p. 11.

JURISDICTION

The judgment of the Court of Appeals was entered on August 29, 1966 (R. 377) (Appendix p. 23). A petition for Rehearing was denied October 6, 1966. (R. 378) The jurisdiction of this Court is invoked under 28 U.S.C. § 1254.

QUESTIONS PRESENTED

1. Whether a Revenue Ruling has such legal effect that it can be held as a matter of law that it frustrated a commercial transaction, particularly where the ruling is subsequently held by this Court to be wrong.

2. Whether respondents were entitled to rescind a sale of a business on grounds of commercial frustration, when the only evidence of frustration consisted of an unenforceable oral agreement to rescind in the "event that the anticipated tax treatment was not obtained," (R. 371, fn. 10) which agreement respondents admit they deliberately concealed from Internal Revenue authorities because its disclosure "might undermine the *bona fides* of the whole transaction in the eyes of the Internal Revenue Service." (R. 226).

STATEMENT

In August, 1951, the individual respondents and D. F. Kinder contracted to sell their stock in Timber Struc-

tures, Inc. to West Los Angeles Institute for Cancer Research (the Institute) for a price of $2,500,000. The transaction was substantially similar to the sale of Clay Brown & Company to the Institute considered in *Commissioner v. Brown*, 380 U.S. 563 (1965). The written documents contained default provisions which permitted foreclosure in the event certain minimum payments were not made. Nothing concerning tax consequences was contained in the written documents but the court found that the parties made an oral agreement for rescission in the event that the anticipated tax treatment was not obtained. Respondents deliberately concealed the oral agreement from the Internal Revenue authorities (R. 372) for the reason that, as they alleged, "it might undermine the *bona fides* of the whole transaction in the eyes of the Internal Revenue Service," (R. 226).

Petitioner dissolved the corporation and leased the assets to a new corporation also known as Timber Structures, Inc. By the end of 1954 petitioner had made payments on the purchase price amounting to $348,886.67.

In September, 1954, the Commissioner of Internal Revenue issued Revenue Ruling 54-420 which dealt with a similar transaction. The ruling stated that the foundation in that case would lose its exemption and the proceeds of the sale would not be entitled to capital gain treatment.

Respondents commenced an action to recover the properties in 1960; however, only in 1962 did they claim rescission on the ground that the purpose of the parties was frustrated by Revenue Ruling 54-420 when issued in 1954. The courts below granted relief on the ground that the transaction was frustrated by Revenue Ruling 54-420. To do so, they relied upon the oral agreement which respondents had concealed from the Internal Revenue Service, although the agreement was not enforceable under the Oregon Statute of Frauds (Tr. 1197).

a. Petitioner claimed that the transaction was not frustrated by the revenue ruling since no tax other than the anticipated capital gain tax had ever been paid by respondents. The Commissioner's claim under the ruling was never sustained, and was rejected by this Court in *Commissioner v. Brown*, 380 U.S. 563. The courts below held that "The consideration bargained for by the sellers was not merely $2,500,000 but $2,500,000 recognized by the IRS as proceeds from the sale of a capital asset and entitled to capital gain treatment," (R. 368; Tr. 1126) The only evidence of such a consideration was the unenforceable oral agreement to rescind in the event the anticipated tax treatment was not obtained.

b. Petitioner also claimed there could be no frustration because the circumstances and procedures for termination had been foreseen and planned for in the fore-

closure provisions. The Court of Appeals rejected this argument on the ground that "Ward Mayer did not accept the default provisions as adequate protection against an adverse tax ruling but requested assurances that the property would be returned if the tax assumptions underlying the transaction were challenged, and that he was given such assurances by representatives of the Institute," (R. 370-371). The oral agreement, which respondents concealed from the Internal Revenue Service, was the keystone of the decision.

REASONS FOR GRANTING THE WRIT

1. The decision below is in conflict with the decision of this Court in Commissioner v. Brown, 380 U.S. 563 (1965).

The courts below granted rescission "on the ground that the sale and leaseback arrangement was frustrated by Revenue Ruling 54-420, 1954-2 Cum. Bull. 128, issued in September, 1954, which rejected the tax premises upon which the transaction was based." (R. 365) Saying that "the ruling denied them the anticipated benefit of capital gain treatment" (R. 367), the Court of Appeals erroneously held the Revenue Ruling to be the law when published in 1954.[1] The Court of Appeals relied upon *Borup v. Western Operating Corp.*, 130 F.2d 381, 386 (2d Cir. 1942) where performance was pro-

1. The ruling is not law and could not deny any tax benefits. A ruling merely "represents the conclusion of the Service as to the application of the law." Rev. Rul. 54-172, C.B. 1954-1, 394, 401.

hibited by the President's proclamation of April 10, 1940 forbidding American ships to go to Norway, then occupied by the Nazis. It also relied upon *Dorsey v. Oregon Motor Stages*, 183 Or. 494, 194 P.2d 967, 971 (1948) where respondent was held to be excused from a contractual agreement to operate appellant's buses on an army post because an executive order prohibited such performance.

In *Commissioner v. Brown*, 380 U.S. 563 (1965), this Court considered an identical transaction between petitioner and Clay Brown & Company. This Court there held the opinion of Revenue Ruling 54-420 to be wrong. It held that in a transaction such as this the law does and did permit the anticipated benefit of capital gain treatment. Because the Revenue Ruling has no force or effect as law, and because *Commissioner v. Brown* stated the law in effect in 1954, it follows that no frustrating event occurred by issuance of the ruling. The effect to be given a revenue ruling is a question of importance which this Court should decide.

2. The decision of the Court of Appeals is directly in conflict with the decisions of this Court as to the proper application of the unclean hands doctrine.

a. The lower court held that although there was a deliberate concealment of significant facts from the Federal taxing authorities (R. 372) other factors "justi-

fied lifting the bar of the maxim" (R. 373) that unclean hands prevent relief in equity. Those factors consisted principally of lack of injury and improper conduct by an agent of the Institute. The decision of the court below balancing the iniquity of the parties is directly in conflict with the decision of this Court in *Precision Instr. Mfg. Co. v. Automotive M. Mach. Co.*, 324 U.S. 806, 65 S. Ct. 993 (1945), where this Court said:

> "* * * This maxim is far more than a mere banality. It is a self-imposed ordinance that closes the doors of a court of equity to one tainted with inequitableness or bad faith relative to the matter in which he seeks relief, however improper may have been the behavior of the defendant. * * *" 324 U.S. 814.

b. The unclean hands maxim is not controlled by state law; it is a self-imposed rule applied by the court for its own protection. *Precision Instr. Mfg. Co. v. Automotive M. Mach. Co., supra; Gaudiosi v. Mellon*, 269 F.2d 873, 881 (3d Cir. 1959); *Hall v. Wright*, 240 F.2d 787, 795 (9th Cir. 1957). It is a matter to be determined by the Federal courts according to the rules and standards of the Federal courts.

3. The decision below is in conflict with the decisions of other circuits.

The Third, Fourth and Fifth Circuits, as well as this Court, have refused to balance the iniquity of the parties in determining whether to apply the unclean hands

doctrine. In *New York Football Giants v. Los Angeles Chargers F. Club*, 291 F.2d 471 (5th Cir. 1961), Flowers signed a contract with the Giants, who orally agreed that the contract would be kept secret in order that Flowers might maintain his amateur standing. Subsequently he entered into a contract with the Chargers. When the Giants sued Flowers, the trial court entered a judgment on the merits in favor of defendant. On appeal the Fifth Circuit held that the case should not have been heard. The Giants were barred by the doctrine of unclean hands even though Flowers had been a party to the secret agreement and no injury resulted to Flowers from the Giants' conduct.

In *Mas v. Coca-Cola Co.*, 163 F.2d 505 (4th Cir. 1947), the Fourth Circuit followed this Court's ruling in *Precision Instr. Mfg. Co. v. Automotive M. Mach. Co.*, *supra*, refused to weigh the respective guilt of the parties, and applied the unclean hands maxim to bar relief.

In *Bishop v. Bishop*, 257 F.2d 495 (3d Cir. 1958), the Third Circuit reversed the trial court and ordered the complaint dismissed because of plaintiff's unclean hands. It followed the rule that equity will not aid a party who has unclean hands regardless of the guilt of the other party. Nor did the lack of injury prevent application of the maxim.

> "* * * it is the moral intent of a person in such a case as this, rather than any actual injury done,

which determines whether he had come into court with clean hands. * * *" 257 F.2d 501

In *Gaudiosi v. Mellon*, 269 F.2d 873 (3d Cir. 1959), the unclean hands doctrine was invoked by the Third Circuit although not raised by defendants or considered by the District Court. Injury was held to be irrelevant.

> "* * * Public policy not only makes it obligatory for courts to deny a plaintiff relief once his 'unclean hands' are established but to refuse to even hear a case under such circumstances. * * *" 269 F.2d 882

The Ninth Circuit in the instant case has clearly adopted a rule of measuring uncleanness and balancing iniquity which is contrary to the rule of this Court and of the Third, Fourth and Fifth Circuits. The question whether the Federal courts will follow the principal of balancing the iniquity of the parties in determining whether to apply the doctrine of unclean hands or whether it will close the doors of the court to one tainted with unclean hands is in dispute and must remain so until settled by this Court.

4. The issue raised by the ruling of the Court of Appeals on the unclean hands doctrine is important in the administration of the Federal tax laws.

Whether taxpayers should be allowed to seek relief in the Federal courts based upon significant facts con-

cealed from the Federal tax authorities is a question with far-reaching effects. Respondents came into the District Court and showed, as an essential part of their proof, significant facts which they concealed from the taxing authorities because they "might undermine the *bona fides* of the whole transaction in the eyes of the Internal Revenue Service," (R. 226). To establish frustration, respondents and the courts below relied upon those concealed facts. They are the heart of plaintiffs' cause of action. Whether a taxpayer who has attempted to improve his tax picture by concealing significant facts from the taxing authorities may have the aid of a court of equity in a cause based upon those concealed facts presents a moral and legal issue of grave and pervasive importance.

CONCLUSION

For the foregoing reasons the petition should be granted.

Respectfully submitted,

HERBERT H. ANDERSON,

Attorney for Petitioner

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

WEST LOS ANGELES INSTITUTE FOR CANCER RESEARCH, *Appellant*, vs. WARD MAYER, et al., *Appellees*.	No. 19,551

[August 29, 1966]

Appeal from the United States District Court for the District of Oregon

Before: POPE, MERRILL and BROWNING, Circuit Judges

BROWNING, Circuit Judge:

In August, 1951, Ward Mayer and his wife and son —who, with D. F. Kinder, were the stockholders of Timber Structures, Inc.—contracted to sell the business to the West Los Angeles Institute for Cancer Research, a tax-exempt entity. The transaction was patterned after the sale and leaseback agreements described in the opinions in *Commissioner v. Brown*, 380 U.S. 563 (1965) and 325 F.2d 313 (9th Cir. 1963). In March, 1960, the Mayers[1] brought this action to recover the property. The district court granted the relief sought, and we affirm, on the ground that the sale and leaseback arrangement was frustrated by Revenue Ruling 54-420, 1954-2 Cum. Bull. 128, issued in September, 1954, which re-

1. D. F. Kinder's interest has been acquired by the Mayer group.

jected the tax premises upon which the transaction was based.

Under the plan, the Mayers sold the stock in Timber Structures to the Institute for $2,500,000 — $10,000 down, the balance payable under the following arrangement. It was agreed that the Institute would lease the business to a newly-formed operating company for a five-year period; that the operating company would pay 80 per cent of the operating profits to the Institute as rent; and that the Institute would return 90 per cent of the rentals to the Mayers in payment of the purchase price of the property. To make these payments possible, it was contemplated that the operating company would deduct the rental payments as a business expense and that the Institute, because of its tax-exempt status, would pay no tax on these receipts. It was contemplated that the Mayers would pay tax on the amounts which they received from the Institute at capital gain rates.

However, in Revenue Ruling 54-420 the Commissioner took the position that in transactions of this type the operating company's rental payments would be taxable to the purchasing entity as unexempt income, and payments to the selling stockholders would not be entitled to capital gains treatment. In October, 1954, when the Mayers had received approximately $350,000 of the $2,500,000 purchase price, they and the Institute were informed by the Internal Revenue Service that the ruling applied to their transaction. The district court found that this "completely frustrated the carrying out of the transaction. The tax consequences which were denied by this ruling where the keystone of the plan, without which it was wholly unfeasible and would never have been seriously considered by the selling stockholders."

Viewed as of the time of the Revenue Ruling,[2] the finding seems unassailable. The Revenue Ruling did not specifically state whether the rental payments could be treated as a business deduction to the operating company, but the rationale of the ruling strongly suggested

2. Borup v. Western Operating Corp., 130 F.2d 381, 386 (2d Cir. 1942).

they (sic) they could not, and instead must be treated as taxable income to the operating company. This, of course, would make it impossible for the operating company to make the contemplated payments to the Institute. In any event, since the Revenue Ruling made it clear that the payments would be taxable income to the Institute, the Institute would be unable to make the contemplated pay-out to the Mayer group. It was also evident that even if the Institute were able to pay the Mayers, completion of the transaction would be calamitous to the Mayers since the ruling denied them the anticipated benefit of capital gain treatment of these receipts.

There was abundant evidence that the parties recognized that application of the ruling to their transaction rendered performance impossible. The parties agreed that no further payments under the contracts would be made, and the Institute did not renew the operating company's original five-year lease. The Institute sought to have the ruling revoked or to exempt their transaction from its application. When these efforts failed the parties undertook negotiations looking toward rescission of the transaction, and reached an informal agreement for the return of the properties to the Mayers, subject to approval of the plan by the Internal Revenue Service.[3]

We agree with the district court that the circumstances would seem appropriate for application of the doctrine of "commercial frustration" or "supervening impossibility of performance," which, as stated by the Oregon Supreme Court, "reads into" contracts "an implied condition that the promisor shall be absolved from performance if, through a supervening circumstance for which neither party is responsible, a thing, event or condition which was essential so that the performance would yield to the promisor the result which the parties intended him to receive, fails." *Dorsey v. Oregon Motor Stages*, 194 P.2d 967, 971 (Sup. Ct. Ore. 1948). See also

3. The Institute also abandoned its efforts to acquire other properties under similar arrangements.

Cabell v. Federal Land Bank, 144 P.2d 297, 302 (Sup. Ct. Oregon 1943). *Compare Eggen v. Wetterborg*, 237 P.2d 970 (Sup. Ct. Ore. 1951); *Strong v. Moore*, 207 Pac. 179, 183 (Sup. Ct. Ore. 1922); and *Elmore v. Stephens-Russell Co.*, 171 Pac. 763 (Sup. Ct. Ore. 1918). But see *Crane v. School Dist. No. 14*, 188 Pac. 712 (Sup. Ct. Ore. 1920).[4]

The Institute argues that rescission of the contract on this ground would be improper for a number of reasons.

First. The Institute contends that performance of the contract is not in fact impossible, because Revenue Ruling 54-420 was rejected in a number of subsequent court decisions which allowed operating companies to treat the rental payments as a business expense,[5] and which allowed purchasing entities to claim their exemption;[6] because in April, 1961, after this action was instituted, the Institute offered to pay the agreed-upon purchase price in full out of funds other than rental payments from the operating company; and because in April, 1965, the Supreme Court in *Commissioner v. Brown*, *supra*, 380 U.S. at 570-73, held that in a transaction of this type selling stockholders would be entitled to capital gains treatment of the payments which they received.

But the "performance" to which the Institute refers is not that contemplated by the contract. Payment in April, 1961, of the balance due on the purchase price would not have accomplished the purpose for which the Mayers entered into the transaction, as the Institute knew. *Commissioner v. Brown* still lay in the future,

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4. No choice-of-law issue having been raised, we accept the parties assumption that Oregon law controls.

5. The Institute cites Anderson Dairy, Inc., 39 T.C. 1027 (1963); Isis Windows, Inc., 1963 P-H TC Mem Dec ¶ 63,176; Oscar C. Stahl, 1963 P-H TC Mem Dec ¶ 63,201.

6. The Institute cites Commissioner v. Johnson, 267 F.2d 382 (1st Cir.1959); Knapp Bros. Shoe Mfg. Corp. v. United States, 142 F. Supp. 899 (Ct. Cl. 1956); A. Shiffman, 32 T.C. 1073 (1959); Ohio Furnace Co., 25 T.C. 179 (1955).

and the agreed-upon purchase price taxable at capital gain rates was not the equivalent of that purchase price taxable as ordinary income. As the district court found, "The consideration bargained for by the sellers was not merely $2,500,000 but $2,500,000 recognized by the IRS as proceeds from the sale of a capital asset and entitled to capital gain treatment."[7]

Nor could the result for which the Mayers contracted have been achieved by payment of the unpaid balance of approximately $2,150,000 (over 85 per cent of the purchase price) in April, 1965, when *Commissioner v. Brown* was finally decided. The evidence refuted any suggestion that the parties contemplated that performance could await the favorable outcome of an extended tax controversy. On the contrary, it is clear that the parties intended that all or a substantial portion of the Mayers' investment would be liquidated over a relatively brief period after August, 1951.[8]

Second. The Institute argues that the doctrine of commercial frustration is inapplicable because the parties foresaw the possibility of an adverse tax ruling and included the default provisions in the contract to meet this contingency.

The Institute places particular emphasis upon evidence indicating (contrary to the district court's finding) that the parties did in fact foresee the possibility that the tax premises of the transaction might be chal-

7. It has been suggested that situations of this type are more accurately described as involving frustration of the contracts purpose rather than impossibility of performance. Although literal performance may remain possible, the objectives of the contract contemplated by the parties have become unattainable. 6 Corbin, Contracts § 1322, pp. 332-33 (1962); 6 Id. § 1353; Note, 27 Calif. L. Rev. 460, 462 (1939).

8. The district court found that the principal purpose of Ward Mayer, then nearing 60, was to liquidate his holdings so that in the event of his death his executors would have sufficient cash available to pay inheritance taxes. The transaction was designed to concentrate payments during the years immediately following the sale, and was to be in default (1) if the Institute failed to pay a total of $600,000 in any two consecutive years before half of the $2,500,000 purchase price was paid, or (2) if it failed to pay a total of $400,000 in any two consecutive years after paying half of the purchase price. Estimates prepared by the Institute and submitted to the Mayers during the negotiation of the contract showed complete or nearly complete pay-out within the first five years.

lenged. But that alone would not bar rescission. We think it proper to assume that the Supreme Court of Oregon follows the now more widely accepted view that foreseeability of the frustrating event is not alone enough to bar rescission if it appears that the parties did not intend the promisor to assume the risk of its occurrence.

The ultimate question in every case is "whether or not proper interpretation of the contract shows that the risk of the subsequent events, whether or not foreseen, was assumed by the promisor. If it appears from the nature of the contract as well as from the surrounding circumstances that, although they were reasonably foreseeable, the promisor did not assume the risk of the subsequent events, the contract shows a gap subject to supplementation in accordance with rules of objective law. Conversely, if the contract, properly construed, shows that the promisor assumed the risk of unanticipated events, the occurrence of such events does not excuse performance." Smit, 58 Colum. L. Rev. 287, 314 (1958). See also *L. N. Jackson & Co. v. Royal Norwegian Gov't*, 177 F.2d 694, 699 (2d Cir. 1949); 6 Williston, Contracts § 1953, pp. 5475-76; Restatement, Contracts §§ 288, 461.[9]

In the present case the district court found, on substantial evidence, that the Mayers did not intend to as-

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9. The decisions relied upon by the Institute are not inconsistent with this view.

It is true that Lloyd v. Murphy, 153 P.2d 47 (Sup. Ct. Cal. 1944), placed great emphasis upon the fact that (1) the frustrating event was foreseeable and (2) the contract contained no provision excusing performance, as justifying an inference that the promisor had assumed the risk that the frustrating event might occur. But we do not read the opinion as holding that this inference *must* be drawn from the facts in the face of evidence that the parties actually intended the contrary.

It is also true that the court held in Floyd v. Murphy that the risk is ordinarily not to be shifted from the promisor unless the purpose of the contract is totally destroyed or rendered extremely impracticable, and that it is not enough that performance may have become unprofitable or more difficult or expensive; but this doctrine too is consistent with rescission in the present case.

One or both of these comments are also applicable to the decisions of the Supreme Court of Kansas in Berline v. Waldschmid, 159 Kan. 585, 156 P.2d 865 (1945), and the decisions of the California intermediate appellate courts in Glens Falls Indemnity Co. v. Perscallo, 216 P.2d 567 (1950), and Cutter Laboratories, Inc., v. Twining, 34 Cal. Rptr. 317 (1963).

sume the risk of an adverse tax ruling, and, implicitly, that the express terms of the contract, including the default provisions, were not intended to provide for this contingency. As the district court said, "the selling stockholders made it clear throughout the negotiations that they were relying on the transaction not being challenged. They repeatedly stated they were not buying a controversy or a lawsuit with the government over the validity of the promised tax advantages." The court credited testimony that Ward Mayer did not accept the default provisions as adequate protection against an adverse tax ruling but requested assurances that the property would be returned if the tax assumptions underlying the transaction were challenged, and that he was given such assurances by representatives of the Institute.[10] In the light of these circumstances, it would be untenable to conclude that the parties intended that the Mayers should assume the risk of an adverse tax ruling simply because such a ruling was, in a sense, "foreseeable" and the contract did not expressly excuse performance in the event of its occurrence.

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10. The district court found that in a meeting in July, 1951, "Mayer pointed out that the foreclosure provision which required two years before a default could occur did not cover the matter about which he was concerned, namely, disapproval of the tax aspects of the transaction by the IRS. Furthermore, the foreclosure provisions did not give the sellers any protection in the event the IRS did not allow capital gain treatment of the proceeds. Mayer wanted a provision in the contract that if the IRS disapproved any of the three essential tax features, the properties would be returned and the parties restored as nearly as possible to their original positions. Seagrave [Board chairman of the Institute] repeated that the Institute's board members were honorable men and that they would voluntarily return the properties in the unlikely event that the anticipated tax treatment was not obtained."

The district court also found that "At the closing, Mayer again raised the inadequacies of the default provisions in that the contract did not provide for immediate return of the properties to the sellers if the IRS refused to allow the contemplated tax treatment and in that it failed to provide for rescission if the IRS disallowed capital gains treatment of the income.

"Seagrave again repeated the assurances he had given Mayer concerning previous approvals of similar transactions by the IRS. He mentioned that a provision for return of the properties was 'unnecessary.'"

The Institute objected to the evidence upon which these findings were based on the ground that its admission was barred by Oregon's parol evidence rule, ORS §§ 41.740, 42.220. The district court correctly held that the evidence was admissible to show the circumstance under which the agreement was made, as an aid to the court in interpreting the contract. Seaver v. United States Plywood Corp., 273 F.2d 36, 41-42 (9th Cir. 1959); Card v. Stirnweis, 374 P.2d 472, 474-76 (Sup. Ct. Ore. 1962).

Third. The Institute argues that equitable relief is barred by the doctrine of "unclean hands" since the parties deliberately omitted from the contract an express provision that the transaction would be rescinded in the event of an adverse tax ruling, in order to conceal this understanding from the Internal Revenue Service.

The version of the incident accepted by the trial court was as follows. Ward Mayer wished to have the oral understanding regarding rescission included in the contract but was dissuaded by representatives of the Institute, who purported to be experts in such matters. They did not suggest that the existence of such an understanding would render the transaction any the less entitled to tax treatment which the parties sought. On the contrary, they argued that it would be an "extraneous provision," not relevant to the legitimacy of the transaction from a tax point of view. They urged that it be omitted "as a matter of policy," only "because an examining Revenue Agent might be led to believe that no one would be hurt by IRS disapproval and would for that reason alone disapprove it."

In Oregon, as elsewhere, the decisions offer no clear-cut formula for determining when a plaintiff's wrongful conduct will bar equitable relief. In Oregon, as elsewhere, that determination must be based upon an examination of all of the circumstances and a balancing of all of the factors deemed to be relevant. *Taylor v. Grant*, 279 P.2d 479, 486-88 and 281 P.2d 704, 705 (Sup. Ct. Ore. 1955); Fadeley, The Clean Hands Doctrine In Oregon, 37 Ore. L. Rev. 160, 186-187 (1958). See generally, *Johnson v. Yellow Cab Co.*, 321 U.S. 383, 387-88 (1944); Restatement, Restitution § 140, Comment b (1937).

The relative strength of the policy infringed by the litigant is an important consideration in determining whether relief will be denied (Fadeley, supra, 37 Ore. L. Rev. at 170), and the public policy offended by the deliberate concealment of significant facts from the taxing authorities is a vital one. But however important the policy may be, its violation cannot be considered in

isolation. It must still be evaluated in the light of attending circumstances. Although the governmental policy involved was important and its breach deliberate, the Supreme Court of Oregon granted relief where, in light of all the circumstances, to deny a remedy would "work injustice and wrong." *Taylor v. Grant*, *supra*, 279 P.2d at 488.

We think the circumstances of this case justified the district court's determination that the clean-hands maxim should not be applied. No injury resulted to the public generally, since the anticipated tax benefits were denied despite the concealment, nor did injury result to third parties or to the Institute.[11] The Mayers' offense, though serious, was mitigated by the circumstances that their motive, as found by the district court, was not to gain an unjustified tax advantage by concealing a relevant fact, but rather to assure an evaluation of the transaction on its merits by excluding an extraneous fact which might improperly influence the examining agent.[12] The parties were not in pari delicto.[13] The agents of the Institute, purportedly possessing an expertise which the Mayers lacked, stood in a superior position. They were the active parties, the Mayers reluctantly agreeing to the omission in response to their urgings. And the forfeiture which would be visited upon the Mayers if relief were denied would be extreme.[14]

Perhaps none of these factors alone would have justified lifting the bar of the maxim; but the district court thought their concurrence did,[15] and we agree.

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11. Republic Molding Corp. v. B. W. Photo Utility, 319 F.2d 347, 349-50 (9th Cir. 1963), and see note 14 infra.

12. Carolina Casualty Ins. Co. v. Oregon Automobile Ins. Co., 408 P.2d 198 (Sup. Ct. Ore. 1965); Mock v. Bell Motors, Inc., 380 P.2d 992 (Sup. Ct. Ore. 1963); Kergil v. Central Oregon Fir Supply Co., 323 P.2d 947 (Sup. Ct. Ore. 1958); and Reid v. Multnomah County, 196 Pac. 394 (Sup. Ct. Ore. 1921), relied upon by the Institute, involved wholly sham transactions intended to deceive third parties with respect to a clearly material fact.

13. See 2 Pomeroy, Equity Jurisprudence § 403, pp. 136-37, (5th ed. 1941); *cf.* Restatement, Contracts, § 604; and see note 14 infra.

14. The Institute alleged that at the time of suit the property had a value of twice the contract price, or $5,000,000.

15. Edward N. Fadeley's summary of Oregon law, based upon a thorough review of the cases, includes these conclusions: "The conduct which would in-

Fourth. The Institute argues that suit was barred by limitations, and that in any event the Mayers waived any right they may have had to rescind the transaction.

Despite the literal language of ORS 12.040, the Oregon Supreme Court, at least in suits "of purely equitable cognizance," has followed the general rule that statutes of limitations apply in equity only by analogy. The effect of expiration of the period limiting an analogous suit at law is only to shift to the plaintiff the burden of establishing that his equitable action is not barred by laches.[16] *McIver v. Norman*, 213 P.2d 144, 153 (Sup. Ct. Ore. 1949); *City of Pendleton v. Holman*, 164 P.2d 434, 439 (Sup. Ct. Ore. 1945); note, 29 Ore.L.Rev. 153, 154-55 (1950).[17]

After the Mayers received notice from the Internal Revenue Service that Revenue Ruling 54-420 applied to their transaction, five and a half years passed before the Mayers filed suit. But it is well established in Oregon law that mere lapse of time does not constitute laches. The question is whether the enforcement of the claim would be equitable. This is to be determined by an examination of all of the circumstances of the particular case. The factor of greatest significance is the presence or absence of injury to another. Indeed, the Oregon

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voke the maxim . . . must cause harm to the adverse party, to the government or to a third person or persons. * * * A party less at fault will generally be freed from the operation of the maxim . . .

"The maxim is applied to protect the court and not to punish a wrongdoer or to protect a defendant. Thus, it will not be allowed to operate to produce an inequitable result. The policy embodied in the maxim may be outweighed by other policies in a given situation, and the maxim therefore not applied. * * * No general rule can be formulated except that the policies involved in the peculiar facts of each case will be balanced and the clean-hands maxim applied or not applied as a result of this balancing." 37 Ore. L. Rev. 160, 187 (1958).

16. Although we would be inclined to the view that the analogous period of limitations would be either the six-year period of ORS 12.080(1) or the ten year period of ORS 12.140, rather than the two-year period of ORS 12.110, as the Institute contends, we do not resolve the issue. We assume for the purpose of this opinion that the burden rested upon the Mayers to negate the existence of laches.

17. The actual holding of Harris v. Harris, 357 P.2d 419 (Sup. Ct. Ore. 1960) is not inconsistent with this view since the action was for the recovery of debt. We think the district court properly concluded that the Supreme Court of Oregon did not intend by the language employed in its brief opinion to reject, without discussion, the well-established doctrine stated in the text.

courts have repeatedly stated that such injury is an essential element of the defense. *Brusco v. Brusco*, 407 P.2d 645, 647 (Sup. Ct. Ore. 1965); *County of Lincoln v. Fischer*, 339 P.2d 1084, 1096 (Sup. Ct. Ore. 1959); *Kelly v. Tracy*, 305 P.2d 411, 421 (Sup. Ct. Ore. 1956); *McIver v. Norman*, 213 P.2d 144, 152 (Sup. Ct. Ore. 1949).

In the present case the first year of delay resulted from the Institute's unsuccessful efforts to induce the Internal Revenue Service to change its position. During all but approximately ten months of the remaining period, the parties were negotiating with the Service and with each other for the return of the property to the Mayers. It was not until May, 1959, the district court found, that the Institute unequivocally announced that it would not return the properties. *Compare Kelly v. Tracy*, 305 P.2d 411, 420 (Sup. Ct. Ore. 1956). Suit was filed ten months later.

As we have noted, the parties treated the contract as frustrated shortly after notification of the applicability of Revenue Ruling 54-420. There is nothing in the record to indicate that the Institute subsequently changed its position in any way which would lead to its prejudice if the transaction were now rescinded. The Mayers have retained exclusive possession and operating control of the business. All of the risks of the enterprise have been theirs. There is no suggestion that evidence has been lost, or that the Institute's defense has been otherwise embarrassed. No injury to third parties is asserted.

The Institute relies upon a single circumstance to establish injury to them from the Mayers' delay in filing suit—the value of the property has increased substantially.[18] But an enhancement of the value of the property involved does not alone convert delay into laches. *County of Lincoln v. Fischer, supra*, 339 P.2d at 1098; *McIver v. Norman, supra*, 213 P.2d at 153-54 and 205 P.2d at 140. Indeed, as in this case, an interim appreciation in

18. See note 14 supra.

value may strengthen the equities of the party seeking return of the property. Where the subject matter is speculative and subject to rapid fluctuation in value, as are oil and mining properties, the doctrine of "speculative delay" may bar a claim to ownership if the claimant asserts his interest only after the risk has passed and the value of the property has become apparent. *McIver v. Norman, supra*, 213 P.2d at 153. But that is not this case. As we have noted, the risks of the enterprise remained with the Mayers. Moreover, the properties were not highly speculative in character, and to the extent that the enhancement of their value was the product of managerial effort, the effort was that of the Mayers.

As to waiver, the district court found that the Mayers "did not intend to and did not elect to affirm the transactions" after the promulgation of the revenue ruling. This finding is amply supported. There was evidence that the Mayers pressed for the return of their properties from the time the Institute's efforts to avoid the application of Revenue Ruling 54-420 failed, until the Institute unequivocally rejected the Mayers' claim ten months prior to suit.

The judgment is affirmed.

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

WEST LOS ANGELES INSTITUTE FOR CANCER RESEARCH, *Appellant*, vs. WARD MAYER, ET AL., *Appellees*	No. 19,551

* * * ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court, that the judgment of the said District Court in this Cause be, and hereby is affirmed.

Filed and entered August 29, 1966

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In the Supreme Court

of the United States

OCTOBER TERM, 1966

No. 798

WEST LOS ANGELES INSTITUTE FOR CANCER RESEARCH, a corporation,

Petitioner,

v.

WARD MAYER, MARJORIE MAYER, R. W. MAYER, and TIMBER STRUCTURES, INC., a corporation, individually and as successors in interest to Ward Mayer Structures, Inc.,

Respondents.

BRIEF IN OPPOSITION TO A PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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OPINIONS

On April 30, 1964, the district court entered its findings of fact and conclusions of law (R. 312-324) which incorporated its oral opinions of December 30, 1963 (Tr. 1110-1145) and January 9, 1964 (Tr. 1197-1201).

The opinion of the United States Court of Appeals for the Ninth Circuit is reported at 366 F.2d 220. A

petition for rehearing was denied on October 6, 1966, without opinion (R. 378).

STATEMENT OF THE CASE

The facts of this case are well stated by the United States Court of Appeals for the Ninth Circuit (366 F.2d at pp. 222-233). Briefly, the transaction, out of which this controversy grew, involved a sale in 1951 of the stock of a closely held corporation to petitioner, a tax-exempt foundation, with a contemporaneous liquidation and 5-year lease-back of the assets to a new corporation (respondent Timber Structures, Inc.) which was formed to operate the same business. 80% of the profits (before taxes) of the business were to be paid, as rent, to petitioner and 90% of the rent paid over by petitioner to respondents in payment of the purchase price of $2,500,000.00. Petitioner assumed no personal liability to pay other than from rents received. Three tax features were essential to this plan: (i) the proceeds of sale must be treated as capital gains, (ii) the rentals must be deductible to the lessee-operating company as a business expense for federal income tax purposes, and (iii) the rentals must be tax exempt in the hands of the petitioner (366 F.2d at p. 223). Both lower courts have held these three tax consequences were the ". . . keystone of the plan, without which it was wholly unfeasible and would never have been seriously considered by the selling stockholders." (ibid.)

In 1954, while the transaction was still far short

of completion, the Internal Revenue Service announced to the parties that it was disallowing these three essential tax features. This disallowance was based on Revenue Ruling 54-420 (1954-2 C.B. p. 128), in which the Commissioner took the position that the rentals would be taxable income to the purchasing foundation and the payments to the selling shareholders would not be entitled to capital gains treatment. The rationale of the ruling strongly suggested that the rental payments could not be deducted as business expense by the operating company (366 F.2d at p. 223).

Thereafter, the parties agreed that no further payments would be made and they did not renew the lease. After unsuccessful attempts by petitioner to have the ruling revoked or this transaction exempted, the parties negotiated an informal agreement of rescission. In May, 1959, petitioner repudiated this arrangement for the voluntary reconveyance of the properties.

In March, 1960, respondents filed suit for rescission in the United States District Court for the District of Oregon. Jurisdiction was predicated solely upon diversity of citizenship and requisite jurisdictional amount under 28 U.S.C. § 1332.

In this case, the court of appeals has affirmed the district court's finding that throughout the sale negotiations the selling stockholders relied upon the claimed tax consequences of the transaction not being challenged, and repeatedly stated they were not buy-

ing a controversy with the government over the validity of the promised tax advantages. As stated by the court of appeals (366 F.2d at p. 225):

> "The court credited testimony that Ward Mayer did not accept the default provisions as adequate protection against an adverse tax ruling but requested assurances that the property would be returned if the tax assumptions underlying the transaction were challenged, and that he was given such assurances by representatives of the Institute."

The district court, sitting without a jury, heard the testimony of many witnesses during six days of trial. Nearly 500 separate exhibits were admitted into evidence. The trial court's evaluation of the testimony and the documentary evidence, and its application of Oregon substantive law, has been affirmed unanimously by the Court of Appeals.

ARGUMENT

The record presents no substantial question of law which will govern the disposition of other cases, but merely a unique factual situation of interest only to the parties before the Court. There is no substantial federal question and no issue of public importance.

I

Petitioner claims that the decision below is in conflict with *Commissioner* v. *Brown*, 380 U.S. 563, because in 1965 this Court, in effect, held the 1954 revenue ruling to be erroneous as to one facet of the transaction therein involved, namely the denial of

capital gains treatment to the selling shareholders. Petitioner argues that the *Brown* decision stated the law existing in 1954. Such a contention is not realistic.

There is no question here as to the "legal effect" of a ruling issued by the Commissioner of Internal Revenue. Obviously, a revenue ruling is not law but merely ". . . an expression of the official interpretation or policy . . ." of the Commissioner ". . . intended to serve the purpose of establishing principles and policies of the Service in the interpretation and application of substantive tax law" (Rev. Rul. 54-172, C.B. 1954-1, 394, 395). In this case, the lower courts have found that in October 1954 the parties ". . . were informed by the Internal Revenue Service that the ruling [Rev. Rul. 54-420] applied to their transaction" and that ". . . this completely frustrated the carrying out of the transaction" (366 F.2d at p. 223). After explaining how the ruling frustrated the parties, the Court of Appeals summarized the "abundant evidence" that the parties themselves ". . . recognized that application of the ruling to their transaction rendered performance impossible" and they acted accordingly (ibid.).

Thus, the fact of complete frustration occurred in 1954 when the Internal Revenue Service applied the ruling to this transaction. It was then that the parties had to make their decisions. The lower courts were clearly correct in evaluating the situation of the parties as of that time, in accordance with Judge Learned Hand's view in *Borup* v. *Western Operating Corp.*, 130 F.2d 381, 386 (C.A. 2), cert. den. 317 U.S. 672:

> "The question must be answered by some test which can be applied at the time a decision must be made. That test should be whether the interruption then appears to have put an end to the voyage for all practical purposes; that is to say, that nobody with good sense would think it sound commercial judgment to keep matters in statu quo until the period of interruption might end."

Moreover, while the original format of the 1951 stock sale by respondents to petitioner was similar to the transaction described in the Court's 1965 opinion in *Commissioner* v. *Brown*, 380 U.S. 563, the similarity between the two cases ends there. In *Brown*, notwithstanding Rev. Rul. 54-420 (1954-2 C. B. 128) Brown and the institute jointly completed their sale, in part via condemnation of the properties (37 T.C. 461, 481). Brown realized $936,131.85 from rental and the sale of the properties, on which he claimed capital gain (380 U.S. at p. 568). For over five years, Brown litigated this issue with the Commissioner (37 T.C. 461, aff'd 325 F.2d 313 [C.A. 9], aff'd. 380 U.S. 563). Both this case and *Brown* were thoroughly considered by the United States Court of Appeals for the Ninth Circuit and that court, being familiar with the extensive records in both cases, found no conflict in its decisions because the facts and questions of law were indeed different.

II

The only other question upon which petitioner seeks review relates to the lower courts' application of the "unclean hands," or "*in pari delicto*" doctrine, to

respondents' suit for equitable relief. The district court found that none of respondents ". . . was guilty of inequitable conduct in any of the respects contended by defendant" (R. 322). The facts and applicable law on this subject are treated at great length by the Court of Appeals (366 F.2d at pp. 226-227).

The lower court found that "The parties were not *in pàri delicto*" (366 F.2d at p. 227) and petitioner's contentions are based in part on an erroneous reading of the findings below. The finding of fact, affirmed below, was that respondents were prevailed upon by the agents of petitioner, purporting to have an expertise which the respondents lacked and standing in a superior position, to omit a written agreement to rescind because, as petitioner's agents argued, it would be an "extraneous provision," not relevant to the legitimacy of the transaction from a tax point of view (ibid.).

Petitioner's argument that the decision of the Court of Appeals is "directly in conflict" with this Court's decision in *Precision Instr. Mfg. Co.* v. *Automotive M. Mach. Co.*, 324 U.S. 806, as well as decisions of the Third, Fourth and Fifth Circuits, is likewise predicated upon the erroneous assumption that the ". . . unclean hands maxim is not controlled by state law . . . It is a matter to be determined by the federal courts according to the rules and standards of the federal courts" (Petition p. 7).

Federal rules and standards relating to the "unclean hands" maxim would undoubtedly apply in a

federal court action where jurisdiction was founded upon federal statutes, such as the patent laws. *Precision* was such a case.

It is equally clear that where jurisdiction is founded solely upon diversity of citizenship, local law will control the substantive question whether a party should be barred from relief on account of "unclean hands," or because he was "*in pari delicto.*" This rule is implicit in *Guaranty Trust Co. of New York* v. *York*, 326 U.S. 99, reh. den. 326 U.S. 806. In *Steele* v. *General Mills, Inc.*, 329 U.S. 433, 440-441, reh. den. 329 U.S. 834, this Court specifically held that in a diversity case a federal court cannot apply the "unclean hands" doctrine differently than the state courts apply the rule.

Thus, the lower courts were correct in following the equity doctrine as to the limitations on the "unclean hands" defense enunciated by the Oregon Supreme Court in *Taylor* v. *Grant*, 204 Or. 10, 279 P.2d 479, reh. den. 204 Or. 36, 281 P.2d 704, and reviewed in an authoritative article on "*The Clean Hands Doctrine in Oregon*" (37 Ore. L. Rev. 160). As stated by the Court in *Precision Instr. Mfg. Co.* v. *Automotive M. Mach. Co.*, 324 U.S. 806, 815, the chancellor has broad discretion in the application of this maxim to the facts of a particular case. The application of familiar local law to a unique factual situation presents no question warranting review by this Court.

CONCLUSION

On the record before this Court, there is no substantial question or legal issue of public importance, but only petitioner's last desperate effort to secure a further review of a most unique and complicated mass of testimony and exhibits. All this evidence has been fully considered by two federal courts.

The petition for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit should be denied.

Respectfuly submitted,

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